CHALLENGING FINANCIAL REPORTING ISSUES: LOOKING BEYOND THE NUMBERS

Thomas Howell Ferguson P.A.
Certified Public Accountants

Moderator: Canita Gunter Peterson
Panelists: Stephen Andrews, Brandon Mott, and Matt Walker

TAX REPORTING ISSUES

Thomas Howell Ferguson P.A.

Certified Public Accountants

Presented by Stephen Andrews

TOPICS

- Basics of SSAP 101
- Deferred Tax Asset/Liability
- Valuation Allowance
- Admissibility Test
- Tax Reform Proposals

Overview

SSAP 101

- Establishes statutory principles for current and deferred federal and foreign income taxes and current state income taxes.

- **Objectives**
  - 1) To recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset.

  - 2) To recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements of tax returns.

Components of SSAP 101

- Current Income Taxes
  - Current year estimates of income taxes payable or refundable, based on tax returns for the current and prior years.
- Deferred Income Taxes
  - Because tax laws and statutory accounting principles differ in their recognition of various items differences arise between taxable income and pretax statutory income.
- Valuation Adjustment
  - Gross DTAs are reduced by a valuation adjustment if it is more likely than not that some portion will not be realized.
- Admissibility of Income Tax Assets
  - Current income taxes recoverable include taxes expected to be recovered in a sequent period and are considered admitted assets.
  - Adjusted gross DTAs shall be admitted based upon the three-component admission calculation.

Valuation Adjustment

- Gross DTAs are reduced by a statutory valuation adjustment if, based on the weight of available evidence, it is more likely than not (>50%) that some portion or all of the gross DTAs will not be realized.

- The statutory valuation adjustment is determined based on a separate company, reporting entity basis.

- The determination of whether gross DTAs will be realized is based on the existence of sufficient taxable income of the appropriate character.

- All available evidence, both positive and negative, should be considered.

All Available Evidence

- Possible sources of taxable income:
  - Future reversals of existing taxable temporary differences.
  - Future taxable income exclusive of reversing temporary differences.
  - Taxable income in carryback years
  - Tax-planning strategies that would, if necessary, be implemented

- Information about an enterprise's current financial position and its results of operations for the current and preceding years are readily available.

- That historical information is supplemented by all currently available information about future years.

Thomas Howell Ferguson P.A.
Certified Public Accountants

Admissibility Test SSAP 101

- Paragraph 11a:
  - Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions.
- Paragraph 11b:
  - 11b(i):The reporting entity shall admit: the amount of adjusted gross DTAs expected to be realized within the period.

Realization Threshold Limitation Table – RBC Reporting Entities

ExDTA ACL RBC (%)	11.b.i.	11.b.ii.
Greater than 300%	3 years	15%
200 – 300%	1 year	10%
Less than 200%	0 years	0%

  - 11b(ii) Amount above is limited to percentage of surplus as indicated by the table above.
- Paragraph 11c
  - The amount of adjusted gross DTAs that can be offset against existing DTLs.

Thomas Howell Ferguson P.A.
Certified Public Accountants

Proposed Tax Reform

- House leaders preparing to vote on bill
- Senate to begin mark up Nov. 13

- Impacts to Insurance Companies of proposals:
  - Corporate Tax rate drops to 20%
  - Full expensing for capital investments would be permitted for five years
  - Pass-through income reduced tax rate
  - NOL reform – no carrybacks, indefinite carryforward, limit 90% of taxable income
  - Repeal of AMT tax

ACQUISITION COSTS

Thomas Howell Ferguson P.A.

Certified Public Accountants

Presented by Brandon Mott

Acquisition Costs (ASC 944-30)

ASU No. 2010-26

- Amended the following definitions
- Note: Added text is underlined, and deleted text is ~~struck out~~.

Acquisition Costs

- ~~Costs incurred in the acquisition of new and renewal insurance contracts. Acquisition costs include those costs that vary with and are primarily related~~ Costs that are related directly to the successful acquisition of new or renewal insurance contracts.

Incremental Direct Cost of Contract Acquisition

- A cost to acquire an insurance contract that has both of the following characteristics:
  - 1. It results directly from and is essential to the contract transaction.
  - 2. It would not have been incurred by the insurance entity had the contract transaction not occurred.

Thomas Howell Ferguson P.A.
Certified Public Accountants

Acquisition Costs Allowable for Deferral

An insurance entity shall capitalize only the following as acquisition costs related **directly** to the **successful acquisition** of new or renewal insurance contracts:

- a. Incremental direct costs of contract acquisition.
- b. The portion of employee's total compensation and payroll-related fringe benefits related directly to time spent performing any of the following acquisition activities for a contract that actually has been acquired:
  - Underwriting
  - Policy issuance and processing
  - Medical and inspection
  - Sales force contract selling
- c. Other costs related directly to the insurer's acquisition activities in (b) that would not have been incurred by the insurance entity had the acquisition contract transaction not occurred.
- d. Advertising costs that meet the capitalization criteria in paragraph 340-20-25-4.

Thomas Howell Ferguson P.A.
Certified Public Accountants

Acquisition Costs NOT Allowed

All other contract acquisition-related costs should be charged to expense as incurred.

These include costs related to activities performed by the insurer for:

- Soliciting potential customers (*except direct-response advertising capitalized in accordance with paragraph 944-30-25-1A(d)*),
- Market research,
- Training, and
- Administration and overhead

Measurement

Capitalized acquisition costs should be charged to expense in proportion to premium revenue.

Acquisition costs allowable for deferral should be determined based on a percentage relationship of costs incurred to premiums from contracts issued or renewed for a specified period.

The percentage relationship should be applied to applicable unearned premiums throughout the period of the contracts.

INTERNAL USE SOFTWARE

Thomas Howell Ferguson P.A.
Certified Public Accountants

Presented by Matt Walker

Internal Use Software (ASC 350-40)

ASC 350-40

- Provides guidance on accounting for the cost of computer software developed or obtained for internal use.
  - Software is acquired, internally developed, or modified solely to meet the entity's internal needs
  - No plans to market software externally
- Subtopic 985-20 *Costs of Software to Be Sold, Leased, or Marketed*
- Licensing internal-use software from third parties - Subtopic 840-10 *Leases*

Project Stages

- Certain costs incurred should be capitalized depending on the nature of the costs and the **project stage** during which they are incurred.
  - Preliminary Project Stage
  - Application Development Stage
  - Postimplementation-Operation Stage

Preliminary Project Stage

- Internal and external costs incurred during the preliminary project stage shall be **expensed** as they are incurred.

  - **Preliminary Project Stage**
    - Conceptual formulation of alternatives
    - Evaluation of alternatives
    - Determination of existence of needed technology
    - Final selection of alternatives.

Application Development Stage

- Internal and external costs incurred to develop internal-use computer software during the application development stage are **capitalized**.

- Capitalization of costs begins when both of the following occur:
  - a. Preliminary project stage is completed.
  - b. Management authorizes and commits to funding a computer software project that is probable to be completed and the software will be used to perform the function intended.

Application Development Stage (continued)

- Costs to be capitalized include only the following:

  - External direct costs of materials and services consumed in developing or obtaining internal-use computer software.
    - Costs of computer software from third parties
    - Fees paid to third parties for software development
    - Employee travel expenses directly associated with developing software

  - Payroll of employees working directly
    - Coding
    - Testing

  - Interest costs during development stage

Postimplementation-Operation Stage

- Internal and external training costs and maintenance costs during the postimplementation-operation stage are **expensed** as incurred.
  - Training
  - Application Maintenance